AN EVALUATION OF THE NAVY ACCOUNTING SYSTEM

STEPHEN S. D. GRIFFITH

AN EVALUATION OF THE NAVY ACCOUNTING SYSTEM

by

Stephen S. D. Griffith
B.S., 1945, University of Washington,
Seattle, Washington

A thesis submitted to the Faculty of the School of Government, Business, and International Affairs of The George Washington University in partial satisfaction of the requirements for the degree of Master of Business Administration

June 7, 1961

Thesis directed by

Arlin Rex Johnson, Ph. D.
Professor of Business Administration

AN EVALUATION OF THE NAVY ACCOUNTING SYSTEM

PREFACE

For a number of years I have been concerned and at times ashamed of the accusations and charges leveled at the military for being wasteful of the taxpayer's dollar. Our Congress has been mindful of this waste and as a consequence has passed a number of laws to bring about better financial management in the government and especially in the Department of Defense. Although the bulk of the literature and criticism on this subject deal with the budgetary process, most of the criticism insinuates that if commercial accounting practices and techniques were to be adopted by the government our problems would be solved.

The purpose of this study is to explore behind these charges and recommendations, by analysis of the basic accounting system of the Navy; also to examine its relationship to governmental accounting as a whole and to compare it with commercial practices.

The approach attempted has been the examination of accounting principles practiced from the grass roots level of the Navy Organization through the hierarchy to the Congress. An attempt is made to illustrate principles without becoming

inundated in a minutia of detail.

The primary sources of the information are written documents such as standard university text books, library reference books, business periodicals, official Navy Department publications, publications by the bureau of the budget, and financial statements of business and industry (limited to firms with over $250,000 annual sales). Some of the ideas and examples were extracted from lectures and class-room discussion periods over the course of the past year. The analyses, comparisons and conclusions appearing throughout this paper are the writer's.

TABLE OF CONTENTS

CHAPTER I

INTRODUCTION

Accounting Defined

Every type of human activity has a language of its own - mathematics is the language of the physical sciences; accounting is the language of the business world. Accounting data provide the basis for evaluating the performance of every line official in the hierarchy of the corporate structure as well as for the business entity as a whole. The responsible official - whether factory supervisor, plant manager, or corporate president - is accountable to someone or some group for the assets entrusted to him, the costs of carrying out the programs of action, and the amount and quality of the results achieved.

On the other hand, Navy management officials, whether line officers, staff corps officers, or civil service employees have only a vague understanding of accounting in this sense, and are at least thirty years behind their colleagues in the business world. For instance, quality control has not yet been tied in with financial effectiveness nor has there been found a method which states military readiness, capability

and performance in financial terminology in a manner that measures their true worth to the nation in the same fashion that net profits measures management effectiveness of corporate enterprise. In fact, Navy management officials rarely use accounting data for evaluating performance effectiveness of subordinate officials. Burkhead, in tracing the historical aspects of budget development in the Federal Government, explains the reluctance for change on the part of Government officials in these terms:

> In the United States the budget system developed almost a century later than western Europe. This laggard development is attributable not to the inherent slowness of the American mind, but to the relative unimportance of the financial operations of government in relation to the operations of the economy in the years prior to the first World War. . . . It seems characteristic of government in the United States . . . that administrative reforms do not proceed until near crisis is reached. This was certainly the case with the development of budgeting in the United States.[1]

Accounting has been described in many different ways depending upon the purposes for which it is performed, the complexity of the organization being served, and by the ability of management to capitalize on the benefits that can be derived from a good accounting system.

More specifically, accounting has been described as:

> . . . the art of recording, classifying and summarizing in a significant manner and in terms

---

[1] Jesse Burkhead, Government Budgeting, (New York: John Wiley and Sons, Inc., 1956), p. 28

of money, transactions and events which are, in part at least, of financial character, and interpreting the results thereof.[2]

One authority classifies the field of accounting into four branches:

. . . (1) commercial and industrial, (2) governmental, (3) institutional, and (4) fiduciary. . . . Governmental accounting encompasses accounting for the national and state and local governments. . . . Governmental or municipal accounting differs from commercial and industrial accounting, not so much in the methods or techniques used but in the material about which information is gathered and reported. Institutional accounting is concerned with accounting for eleemosynary, religious, and educational organizations. Fiduciary accounting is concerned with insolvent and bankrupt concerns and with trusts and estates.[3]

Some authorities classify the field of accounting according to the purposes served. One authority states that:

In a general way, the purpose of accounting may be said to be to provide information concerning property and the rights to property and to show how property and the rights to it have been affected by business operations.[4]

Another authority views the purpose of accounting to be an essential source of data for the top management decision-making process.

---

[2] Accounting Research Bulletin No. 9, Report of Committee on Terminology, May 1941 (New York: American Institute of Accountants) p. 67

[3] C. Aubrey Smith and Jim G. Ashburne, Financial and Administrative Accounting (New York: McGraw-Hill Book Company, Inc., 1955) p. 8

[4] Howard S. Noble and C. Rollin Niswonger, Accounting Principles Sixth Edition(Chicago: Southwestern Publishing Company, 1953), p. 1

> In the modern business world quantitative economic data must be collected and analyzed to place responsibility, to prevent fraud, to guide in planning, to determine equities, and to assist management in its efforts to secure efficiency.[5]

This same authority views, the field of accounting according to the purposes it serves, as being comprised of three distinct categories: (1) financial accounting, (2) administrative accounting, and (3) tax accounting. Whereas tax accounting is self explanatory, the author's description of financial accounting and administrative accounting is worthy of consideration:

> 1. Financial accounting is concerned primarily with income determination. Its principles and practices point toward preparation and interpretation of financial statements, namely, the balance sheet, income statement, and the surplus statement, together with any supporting schedules. Precise disclosure of the status of properties of the accounting unit and equities of owners, creditors, and others in those properties to the end that all rights are protected is the aim of financial accounting.
>
> 2. Administrative accounting, or managerial accounting, is based upon the concept of accounting as a method of management, or a tool by which managerial effectiveness is enhanced. Although it deals primarily with the same financial data, it is not confined to financial. . . . While financing accounting is chained to history, administrative accounting is free to conjecture. In fact, the utility of administrative accounting depends in large measure upon the discernment with which the accountant predicts the future, whereas the ability of financial accounting depends upon the justice of the accountant's representations of the results of past actions.[6]

---

[5]Smith and Ashburn, _op. cit._, p. 2

[6]_Ibid._, p. 10

Throughout the balance of this thesis the subject of accounting is discussed in terms of the definitions of financial and administrative accounting set forth in the preceeding paragraph.

CHAPTER II

DEVELOPMENT OF ACCOUNTING

Bookkeeping in some form was used for many centuries B.C. in fact, it probably was the forerunner of written communication. It was developed as a means for preventing and settling disputes over property rights. Over the centuries as bookkeeping developed a formal procedure emerged for recording of receipts and disbursements of cash and of amounts owed by customers and to creditors. This method was referred to as single-entry bookkeeping.

The double-entry bookkeeping system came about during the medieval ages as a result of the need to equate the net gain from the capital invested against the risk taken, and to determine how the gain was effected and in this way conclude a future course of action.

Accounting evolved during the eighteenth and nineteenth centuries as an outgrowth of the corporate enterprise when it became necessary to protect the equity of the invested capital by insuring that it was not paid out under the guise of dividends and to allocate revenues and expenses to the proper accounting periods.

History of Federal Accounting

The requirement for accounting by the federal government for the tax-payer's dollar was written into the Constitution by our founding fathers:

> . . . no money shall be drawn from the Treasury but in consequence of appropriations made by law; and a regular statement and account of the receipts and expenditures of all public money shall be published from time to time.[7]

The stipulation for a strict accounting of government funds was no accident. It was brought about by financial difficulties encountered during the Revolutionary War. Kimmel states that:

> It is a historical fact that the Federal Government and the present Constitution owe their existence in part to financial and budgetary considerations. The absence of effective financial powers --- was a major reason for the convention of 1787 that framed the new Constitution. . . . With the ratification of the Constitution, the way was clear for the establishment of a responsible financial system.[8]

This led to the enactment in September 1789 of the law providing for the establishment of the Treasury Department. This legislation provided for concentration of all financial and accounting activities of the Government in the Treasury Department, headed by the Secretary of the Treasury. To assist him in carrying out his duties, five key assistants

---

[7]Article I, Section ix, Paragraph 7 of the Constitution.

[8]Lewis H. Kimmel, Federal Budget and Fiscal Policy 1789-1958 (The Brookings Institution, 1959), p.2.

were designated. They were: an Assistant to the Secretary, a Comptroller, an Auditor, a Treasurer, and a Register. In order to diffuse and distribute power and to discourage fraud, the duties of these officials were carefully allocated and clearly defined. Bartelt describes these duties as follows:

> It was the duty of the Comptroller to superintend the adjustment and preservation of the public accounts; to examine all accounts settled by the Auditor; to certify the balances arising thereon to the Register; and countersign warrants drawn by the Secretary of the Treasury.
>
> The auditor was charged with the duty of auditing all public accounts and of certifying the balances to the Comptroller for review and final determination. Claimants were given the right of appeal from the Auditor's decision to the Comptroller at any time within six months.
>
> The Treasurer was made responsible for the safekeeping of the public funds. He was authorized to disperse the public money only on warrants issued by the Secretary of the Treasury, countersigned by the Comptroller and recorded by the Register.
>
> The Register was the official bookkeeper. It was his duty to keep all accounts of the receipts and expenditures of public money and of all debts to or from the United States. He recorded all warrants issued by the Secretary.[9]

Hamilton served as Secretary of the Treasury from 1789 to 1795. During this period he transferred obligational authority between appropriations without restraint, much to the chagrin of the Congress. He was succeeded in office by Walcott, who continued Hamilton's policies. This led to the

---

[9]Edward F. Bartelt, Accounting Procedures of the United States Government (Chicago: Public Administration Service, 1940), p. 44.

establishment of a temporary Ways and Means Committee by the Congress in 1796 whose purpose was to watch over expenditures as well as revenues. In 1802 this committee was made permanent. From this point on the executive branch continued to lose freedom of action in the expenditure of appropriations as the Congress grew more and more specific in their wording of the purposes for which various appropriations were to be spent.[10] In fact, until today

> The aim of twentieth century budget reform has been to recover for the Executive Branch, functions that Hamilton could have won but lost . . . Control of the purse had been both the symbol and the instrument of legislative authority over the Executive. It remains true today . . . that no proposals for budgetary reform that contemplate inroads on the authority of Congress have any prospects of success.[11]

The next significant legislative act in regard to governmental accounting was the Cockerell-Dockery Act of July 31, 1894, in which the Congress continued the tradition established by Hamilton.

> . . . that all accounts of receipts and expenditures of public money (except postal) shall be maintained in the Treasury. . . . such accounts . . . are limited primarily to transactions involving (1) deposits of money in Government depositaries; (2) appropriations made by Congress; and (3) warrants authorizing the transfer of disbursing credits from appropriation accounts on

---

[10] See <u>infra.</u>, p. 20 for current problems caused by the appropriation structure.

[11] Bartelt, <u>op.cit.</u>, p. 126.

on the books of the Secretary of the Treasury to checking accounts of disbursing officers on the books of the Treasurer of the United States.

They do not reflect accruing revenues and expenses, nor the assets and liabilities of the Government. Such transactions are to a large extent, but not completely, reflected in the accounts of several hundred different administrative agencies, disbursing offices, collecting offices, and depositaries.[12]

The Budget and Accounting Act of 1921 preserved the system established by Hamilton and sanctioned by the Cockerell-Dockery Act of 1894. However, the Act of 1921 did establish a new office under the legislative branch of the Government entitled the General Accounting Office, headed by the Comptroller General of the United States. To this new office of the legislative branch was transferred the function of Comptroller of the Treasury, the Auditors and the accounting functions of the Secretary of the Treasury.

The former Comptroller of the Treasury and the six Treasury Auditors were commonly known as the accounting officers of the Government. The principal duties of the Comptroller were: (1) to countersign Treasury Warrants; (2) to render decisions concerning the availability of appropriations; and (3) to review settlements made by the auditors. The duties of the auditors were to audit and settle the personal accounts of disbursing officers, collecting officers, and claimants.

Neither the Comptroller nor the auditors were accounting officers in the broadest sense of that term. Their time and energy were taken up almost entirely with matters relating to the audit and settlement of accounts.[13]

---

[12] Ibid.

[13] Ibid., p. 127.

Strange as it may seem, the Budgeting and Accounting Act of 1921 assigned to these men the responsibility for prescribing the forms, systems and procedures for administrative, appropriation and fund accounting for the federal government.[14] Little wonder that governmental accounting is steeped in the philosophy of audit trails and legality of transactions and with a corresponding weakness in managerial phases of accounting. Another result of this is that the Treasury Department is still on a "cash" basis of accounting.[15]

In 1939 Mansfield made the following poignant remarks in regard to the manner in which the Comptroller General carried out the responsibilities assigned to him by the Budget and Accounting Act of 1921:

> The Congress which passed the Budget and Accounting Act supposed that it was providing itself with an independent critic of executive conduct in the use of public funds. . . . The academic advisors of the committee did not forsee, and the Congressional Stalwarts on it either did not see or did not

---

[14]The Budget and Accounting Act, 1921, 42 Stat; 31 U.S.C. 49 states: "Sec. 309 The Comptroller General shall prescribe the forms, systems, and procedure for administrative appropriation and fund accounting in the several departments and establishments."

"Sec. 112 - The General Accounting Office shall cooperate with the executive agencies in the development of their accounting systems. . . . Such accounting systems shall be approved by the Comptroller General when deemed by him to be adequate and in conformity with the principles, standards, and related requirements prescribed by him. . . . The General Accounting Office shall from time to time review the accounting systems of the executive agencies."

[15]Chap. III, infra, Treasury Accounting

> care that the Comptroller General's Office was endowed with powers that would make him less a critic than a petty tyrant. . . . Its main result has been to load the process of administration with an intolerable burden of overhead cost, to tie the hands of administrative offices in bundles of red tape. . . . and to divert the time and energy of responsible officials continually from substance to form.[16]

Government accounting struggled along without change under the supervision of the GAO auditors until 1945 when Congress enacted the Corporation Control Act (59 Stat. 597, 31 U.S.C. 841 1945) which required the Comptroller General to conduct "commercial-type" audits of Government corporations. Under this act the GAO was required to shift its audit emphasis from form to substance in the audits of Government corporations. The effect of this act was far reaching and constituted the first step toward reform of the accounting system which had remained substantially unchanged since it was established by Hamilton.

A good description of the conditions that led to the enactment of this legislation is provided by Kohler and Wright:

> The scope of the financial transactions involved in World War II created new problems and new demands for better Government records. The services and skills of large numbers of businessmen were enlisted in the conduct of Government activities. These individuals, accustomed to reliable and prompt accounting data on past, present, and future

---

[16]Harvey C. Mansfield, <u>The Comptroller General</u> (New Haven: Yale University Press, 1939), p. 2.

> operations, became aware that the kind of accounting and reporting which they had found invaluable in private business was not available in the Government. . . . the exigencies of War did not justify the risk . . . of interruption . . . that might have followed a wholesale revamping of basic concepts.[17]

The Origin and Development of Financial Management Control in the Executive Office of the President and the Secretary of Defense

By 1948, the seeds of new thought implanted in the GAO by the Government Corporation Control Act of 1945 had begun to bear fruit. A joint standing committee was formed comprised of the top officials from the three major fiscal agencies: the Treasurer, the Comptroller General, and the Director of the Bureau of the Budget. Its purpose was to initiate action to improve financial management and accounting in the federal government. Their efforts are known as the "Joint Program to Improve Accounting in the Federal Government". This program was undertaken as a joint effort to avoid jurisdictional disputes among the GAO and the several bureaus and agencies of the executive department which had proven to be the major roadblock to improvement of government accounting since 1921. This program was officially announced on October 20, 1948 by the Comptroller General in a letter to the heads of all governmental departments and

---

[17]Eric L. Kohler and Howard W. Wright, Accounting in the Federal Government (Englewood Cliffs, N.J.: Prentice Hall, inc. 1956), p. 5.

agencies. The objectives of the program as announced by the Comptroller General were:

> The program contemplates the full development of sound accounting within each agency, as a working arm of management, in terms of financial information and control. At the same time it envisions an integrated pattern of accounting and financial reporting for the Government as a whole responsive to executive and legislative needs.[18]

This statement of policy officially recognized for the first time, that the requirements of the executive for financial information and controls were of equal importance as those of the legislative.

The first Hoover Commission Report in 1949 reiterated the need for financial improvement and gave the stamp of approval to the committee.

Furthermore, the joint program was endorsed by the Congress in the Budget and Accounting Procedures Act of 1950. In section 111 of that act, the Congress stated:

> It is the policy of the Congress in enacting this part that . . . (f) The Comptroller General of the United States, the Secretary of the Treasury, and the Director of the Bureau of the Budget conduct a continuous program for the improvement of accounting and financial reporting in the Government.[19]

---

[18] U.S., Senate, Committee on Government Operations, Financial Management in the Federal Government, Senate Document No. 11, 87th Congress 1st Session (Washington D.C.: U.S. Government Printing Office, February 13, 1961), p. 41.

[19] U.S. Congress, Budget and Accounting Procedures Act of 1950, Public Law 784, 81st Congress, 2nd Sess., 1950.

The efforts of these three agencies are coordinated through joint program working arrangements. Leadership is provided by the three agency heads. Two joint committees have been established to carry out the joint efforts on a continuous basis. One committee guides projects involving government wide and civil agency financial management improvements. The other committee, composed of representatives of the three central agencies and the Department of Defense, handles joint matters related to financial management improvements within the Department of Defense. The committees on Appropriations and Government Operations in both the Senate and the House have been active in the efforts of the joint program.

This committee's work, based upon the findings and recommendations of both Hoover Commission Reports, led to the enactment of several significant pieces of legislation.

Status of Implementation

The first significant piece of legislation was Public Law 216, approved August 10, 1949, commonly known as the "National Security Act Amendments of 1949". Title IV of this act, "Promotion of Economy and Efficiency Through Establishment of Uniform Budgetary and Fiscal Procedures and Organizations" transferred the responsibility for the development and supervision of financial systems, techniques and management from the General Accounting Office to the Comptroller of the Department of Defense. The Act established

the position of Comptroller of the Department of Defense, and designated the position as one of the Assistant Secretaries. The Act stipulated that the Comptroller shall:

> Establish and supervise the execution of:
> (A) Principals, policies, and procedures to be followed in connection with organizational and administrative matters relating to:
> (i) the preparation and execution of budgets
> (ii) fiscal cost, operating and capital property accounting
> (iii) progress and statistical reporting
> (iv) internal audit[20]

Furthermore, the Act established separate positions of Comptroller of the Navy, Comptroller of the Air Force and Comptroller of the Army under the Secretary of each of the services.

Public Law 216 further provided for establishment of working funds, and capital funds. The provision for working funds was written into the law because of the success the Navy had achieved over the years with the Naval Stock Fund operation. The law did, however, cause attention to be drawn during subsequent budget reviews to the other large Navy inventories, and caused many such inventories to be transferred to t he Naval Stock Fund; two recent transfers were ordnance and shipboard machinery repair parts. As a direct result of transferring these stocks to the Naval Stock Fund, no further procurement of Navy inventories has been funded from the operation and maintenance appropriation since July 1, 1960.

---

[20]U.S., Congress, <u>National Security Act Amendments of 1949</u>, Public Law 216, 81st Cong., 1st Sess., Sec. 401(6)

The authorization of capital funds led the Navy to establish commercial-industrial type financial accounting procedures within the shipyards and ordnance plants. This program has not been fully implemented as yet, especially at the industrial-type air stations. The major conflict has centered on whether the aircraft overhaul facility was a tennant activity of the air station or whether the air station was a tennant activity of the aircraft overhaul facility. There is a third faction that expounds the opinion that it makes little difference as long as all activities at any single station are on the same accounting system. This argument has not been resolved to date.

Comptroller type positions within the Navy, have been established at every bureau, office, and operating unit. In most installations the position carries the title of Comptroller; in others, planning officer, fiscal officer, supply officer, or material officer. Nevertheless, the positions have been established and the comptrollership function, as envisioned by the Hoover Commission and the Joint Accounting Committee, is being carried out as well as can be expected considering the environment in which it operates. At the present time, the Comptrollership function within the Navy is hamstrung by handicaps: (1) the appropriation structure, and (2) the channels through which the directives and funding authorizations flow which are generally in conflict with the formal organization of the Navy. The appropriation structure is set up primarily to enable Congress

to provide funds for specific purposes, including pet projects and installations in their home districts; and the accounting system has been designed to report the degree of compliance with these appropriation acts.

One must continually bear in mind that the Congress is composed of officials elected for the specific purpose of representing the voters of a particular district; and every Congressman must meet the critical test of the ballot box; every two years by the Representatives and every six years by the Senators. By and large their views are sharply oriented toward their home districts. The Executive Branch, on the other hand, orients its actions toward the overall welfare of the nation as a whole, and the furtherance of a particular department or agency.

Congress did acknowledge the need for further improvement in financial management techniques throughout the government by the enactment of a second significant piece of legislation, Public Law 863, approved August 1, 1956.[21] This law provided for the following:

1. Accounting on an accrual and cost basis - Section 2 (b) and (c).

2. Budgeting on a cost basis. Section 1

3. Use of consistent classifications. Section 2 (a)

---

[21] U.S., Congress, An Act to Improve Governmental Budgeting and Accounting Methods and Procedures, and for Other Purposes, Public Law 863, 84th Cong., 2nd Sess.

4. Justification data by organization. Section 2 (a)

5. Simplification of allotment structure. Section 3

Section 3 of Public Law 863 states that: "agencies shall work toward the objective of financing each operating unit, at the highest practical level, by a single allotment from each appropriation fund involved."[22]

The underlying concept is that the appropriation and budget activity structure should coincide with the organizational structure so as to eliminate the problem of funds being administered from an organizational unit separate from the unit directing the operations. Furthermore, since the concept originated with the Hoover Commission and the Joint Accounting Committee, it entails the requirement for rendering accounting reports in a manner similar to that carried on within a corporate enterprise.[23] At the factory level a full accounting is made of all receipts, expenditures, assets and liabilities. The factory manager renders a full accounting report to the district manager, who consolidates the reports from all of the plants within his district and reports to the division manager. The division manager consolidates all of the reports from the districts and reports to the company president.

---

[22] Executive Office of the President, Bureau of the Budget, Improvement of Financial Management in the Federal Government, Bulletin No. 57-5 (October 10,1956), p. 8.

[23] *Supra*, p. 13. for history and purpose of Joint Program to Improve Accounting in the Federal Government.

The Army and the Air Force are so organized that implementation of this scheme can be accomplished with relative ease. But this is not so within the Navy. For instance, the Commander of a Navy Base, or the Commandant of a Naval District, who occupy positions corresponding to the district manager of a corporate structure are not in the echelon of budgeting, allotment control, or reporting. Hence they exert little effective control over financial operations. Funding does not follow organizational lines. This results in various bureaus funding programs at activities not under their management control. For instance, at a typical Naval Air Station: BuWeps funds the maintenance and operation of the air facility, BuPers funds certain training programs, BuShips funds the electronics installations and equipment, and BuSandA funds most of the inventories. In the case of the operating forces; the Chief of Naval Operations issues the orders, BuWeps funds the weapons and ammunition, BuShips funds the ships and the electronics, BuPers funds the personnel, and BuSandA funds the inventories. Mosher, in his analysis of budgeting within the Department of Defense, concluded that:

> The Navy molded its appropriation structure around the existing organizational structure of its bureau system. . . . the result is a classification that is functional in the same degree that the organization of Navy bureaus is functional. But the actual organization of the bureaus is more the product of history and tradition than of a logical analysis and division of functions. They could probably be described

> more accurately as units distinguished by subject matter and technical specialism than by function or program.[24]

It is practically a foregone conclusion that implementation of Section 3, Public Law 863 which is scheduled for July 1, 1965, will result in significant changes to the organizational structure and funding procedures within the Navy.[25]

The use of the same standard budget programs and consistent budget classifications within the Navy, Army, and Air Force is scheduled for implementation on July 1, 1962. This will require the grouping of individual Navy appropriations under one of the following eight budget classifications established by the Secretary of Defense:[26]

1. Operating Forces
2. Training and Personnel Support
3. Reserve Forces
4. Central Supply Activities
5. Major Overhaul and maintenance of aircraft, ships, and material.
6. Medical Activities
7. Service Wide Activities
8. DOD Wide Activities

---

[24]Frederick C. Mosher, Program Budgeting: Theory and Practice (Public Administration Service, 1954), p. 85.

[25]*Infra*, Chap. V

[26]RADM Lot Ensey, Assistant Comptroller of the Navy, in an address before the Navy Graduate Comptrollership Program at the George Washington University on February 10, 1961.

The purpose of such classification is:

> . . . to place the budgets of the Army, Navy, and Air Force on a comparable basis. The appropriation structures of the three services are not uniform . . . although many changes have been made in recent years to make them similar in many respects . . . with the result that the category system was devised to permit more meaningful comparisons between the services.[27]

Navy accounting is still performed on the obligation basis.[28] However, double-entry bookkeeping methods and principles are now required throughout the Navy. Furthermore, accrual accounting for the Operation and Maintenance Appropriation is scheduled for implementation on July 1,1962.[29] The Bureau of the Budget Circular A-11, Which prescribes basic instructions for preparation of agency budgets, specifies that agencies must use accrual accounting methods before their budgets are considered to have met the requirements for cost-based budgets. Except for the accrual accounting requirement, the Navy accounting system otherwise provides the data required to meet the cost-based criteria. According to the Navy Comptroller, the Navy is scheduled to switch over to a fully integrated accrual accounting system for all resources and expenditures, and to cost-based budgets on July 1, 1963.[30]

---

[27] U.S., Department of the Navy, Office of the Comptroller, The Budget Process in Navy, NAVEXOS P-1254 (June 1960), p. 2-6.

[28] *Infra*, p.26

[29] RADM Ensey, *op. cit.*

[30] *Ibid.*

Analysis of these laws individually clouds the basic intent of Congress, which is to improve economy, efficiency, and financial management in the Armed Forces through creation and development of a strong and effective Secretary of Defense.[31]

It is evident that Congress has acknowledged the physical impossibility of their attempting to manage a $40 billion annual defense appropriation without the direct assistance of the Executive Branch. Consequently, in order to insure the active participation of the Executive Branch, Congress, by means of Public Law 216, shifted the responsibility and authority for financial management from the legislative (GAO) to the Secretary of Defense. Many officials within the military departments, who should know better, fail to recognize or acknowledge this shift in power.

Many of the top management officials within the various bureaus and offices of the Navy formerly presented budgets for their programs direct to the House and Senate

---

[31]This conclusion was drawn from a study of the two Hoover Commission Reports and the following Public Laws:

U.S., Congress, National Security Act of 1947, Public Law 253, 80th Cong., 1st Sess., 1947

U.S., Congress, National Security Amendments Act of 1949, Public Law 216, 81st Cong., 1st Sess., 1949.

U.S., Congress, Budget and Accounting Procedures Act of 1950, Public Law 784, 81st Cong., 2nd Sess., 1950

U.S., Congress, An Act to Improve Governmental Budgeting and Accounting Methods and Procedures, and for Other Purposes, Public Law 863, 84th Cong., 2nd Sess., 1956.

Committees. Over the years strong ties and a mutual respect developed between these officials and certain Congressmen. Naturally many of these strong ties still remain in spite of the fact that these officials are now only called upon to testify in the role of supporting witnesses. But the psychological effect of former relationships clouds the minds of many officials and obscures the fact that the Secretary of Defense wields more direct influence over their programs than does the Congress. The requirement for better financial management is well understood by the Secretary of Defense. As soon as the means to obtain this objective are developed and promulgated, the power vested in this office will become more apparent.

CHAPTER III

BASIC CONCEPTS OF NAVY ACCOUNTING

Overall Concept

The Navy Accounting System in use today was designed under the supervision of the GAO auditors during the period from 1921 to 1950. Its primary purpose is to report degree of compliance with the will of Congress as expressed in the appropriation acts. It provides details as to who spent how much for what and when. The underlying concept is deceivingly simple: Congress appropriates funds for specific purposes and the Executive Branch spends it, occasionally for other purposes; the accounting system measures the variance.

It is not a financial management system in that it does not equate the things the Navy does - missions and tasks - to the total costs of performing these missions and tasks or to predetermined goals or standards.

The operating forces of the Navy are organized around large pieces of hardware - ships and aircraft - which are selected on the basis of assigned tasks and missions. Funds which are provided from various appropriations for equipment, personnel, operation and maintenance are not

related to this hardware. Neither are the corresponding costs of operation and maintenance of the shore establishment equated on a benefit derived basis, or on any other basis, to missions, tasks or weapons systems. The net effect of this is the creation of doubt as to the validity of requirements and the value derived from the expenditures.[32]

Obligation Basis

In analysis of the Navy accounting system one should bear in mind that all Navy accounts are maintained on the "obligation" basis as differentiated from the "accrual" basis. The obligation basis of accounting is defined as:

> The basis of accounting for appropriations or contract authorizations whereby obligations are recorded in the accounts when incurred, and appropriations, allotments, or contract authorizations are reduced accordingly, regardless of whether the expenditures are to be made in the same fiscal period. On this basis appropriation

---

[32] Professor C. Northcote Parkinson, University of Singapore, Malaya, published an article on the relationship of the growth of the British Shore Establishment to the reduction in the size of the British Fleet during the period of 1914 to 1954. He found that employment of dockyard officials and clerks rose 40% and the Admiralty officials rose 78% while Royal Navy ships in commission decreased 68% and the officers and men in the Royal Navy decreased 32%. During the period of 1914 to 1928 the number of Admiralty officials rose on the average of 5.6% per year; between 1935 and 1939, 5.2%;between 1947 and 1954, 6.5%. "The officials would have multiplied at the same rate had there been no actual seamen at all." C. Northcote Parkinson, "Parkinson's Law," Readings in Management, ed. Harold Koontz and Cyril O'Donnell, (New York: McGraw-Hill Book Company, Inc., 1959), p. 54.

> and fund accounting statements identify appropriations and charges for expenditures thereunder with the fiscal year in which obligations are incurred.[33]

Whereas the accrual basis of accounting is defined as:

> The basis of accounting whereby revenues are accounted for when earned, even though not collected; operating costs are accounted for in the fiscal period during which benefits are received; costs for which the benefits are applicable to future periods are deferred as assets; and liabilities for costs or (expenditures) are recorded when goods or services are received whether or not paid for.[34]

Treasury on a Cash Basis

The function which the U.S. Treasury performs for the government is similar to that which a commercial bank performs for its private investors in that the scope and extent of their financial operations are determined by the cash position and the cash flow during the period of time being considered.

Treasury operations differ from bank operations in that appropriations do not in themselves create new money for the Treasury, whereas deposits to a commercial bank do provide the working capital for the operations of the bank. Kohler and Wright provide the following explanation of the relationship of appropriations to Treasury cash:

> An appropriation . . . is an authority to incur obligations in a limited total amount and to disburse

---

[33]U.S., Department of the Navy, Office of the Comptroller, Navy Comptroller Manual, NAVEXOS P-1000, Vol. I, Appendix A, p. 1-7.

[34]*Ibid.*

> cash. . . . It does not create or otherwise provide cash. It is the responsibility of the Treasury Department to make sure that current receipts or borrowings will meet the demand for cash. If current receipts from taxes are inadequate, additional Government securities must be sold.[35]

However in one sense, appropriation acts may be likened to commercial checking accounts in that they serve as controlling devices over the amount spent or charged for specific purposes.

The accounts of the U.S. Treasury reflect the cash on hand and the gold supply position of the U.S. Government.

Appropriation accounts are maintained in the Division of Accounts of the Treasury Department. These accounts are held separate from and are not part of the cash accounts maintained on the other side of the house by the Treasurer. Their purpose is to introduce a measure of balance by the Secretary of the Treasury between the release of obligation authority to the spending levels, and the cash on hand, gold supply, and revenues available to pay for these spending authorizations. This balancing technique is pursued through; (1) the process known as apportionment, and (2) by the President by impounding or withholding spending authorizations. An example of the latter was provided by President Truman in 1948 when he impounded the authority appropriated by Congress to provide for a seventy-group Air Force.[36]

---

[35]Kohler and Wright, <u>op. cit.</u>, p. 117.

[36]The authority of the President and the Bureau of the Budget to withhold funds was reaffirmed by passage of the

One authority explains these relationships as follows:

> . . . there is no single Federal Government accounting system. Yet consolidated financial data for the Government as a whole is needed . . . by many individuals and by various Governmental agencies. . . . some agencies maintain accounts on an accrual basis, some on a cash basis, others on a compromise basis. . . . there are other, more limited types of data readily available; cash payments (that is, checks cleared) by the Treasurer, and checks issued by disbursing officers. Both sources are used, and two different reports are the result. One known as the "Daily Statement of the United States Treasury" contains information obtained from the accounts of the Treasury of the U.S.: cash deposits and withdrawals, and closing balances.[37]
>
> In another summary known as "Monthly Statement of Receipts and Expenditures of the United States Government," issued on the 15th day of each month covering the month preceeding, the Treasury Department summarizes receipts by sources, and expenditures[38] by bureau or sub-bureau. From these data it is possible to develop budget surpluses or deficits, and the way is opened for whatever financing action is required. The statement is prepared within the Bureau of Accounts from information submitted by disbursing officers on checks issued and by collecting officers on cash received:

General Appropriation Act of 1950 which provided that: "In apportioning any appropriation, reserves may be established to provide for contingencies, or to effect savings whenever savings are made possible by or through changes in requirements, greater efficiency of operations, or other developments subsequent to the date on which such appropriation was made available." 64 Stat. L. 595, Sec. 1211.

[37]Kohler and Wright, op. cit., p. 118.

[38]The different meanings of "expenditure" should be distinguished. As used within the Treasury an expenditure occurs when a check is issued, a cash disbursement when the check is paid by the Treasurer. From the viewpoint of an agency, an expenditure is made when goods and services are received, a cash disbursement when the check is issued. Kohler and Wright, op. cit., p. 119.

data extracted from its records and those of the Treasurer.[39]

Therefore, the Treasurer of the United States is not unlike the Treasurer of a large corporation. He holds the monetary gold and silver, accounts for receipts and expenditures, and advises the President when the supply is getting low and when anticipated expenditures exceed anticipated receipts.

Two Separate Systems: Appropriation Accounting and Disbursing

The most distinctive characteristic of the Navy accounting system is its complexity. It is comprised of a number of accounting entities, each representing a separate appropriation or fund.[40] These accounting entities radiate outward, like spokes of a wagon wheel, from the central accounts maintained in the office of the Navy Comptroller to the various bureaus and offices. The procedural doctrine, which transcends most of the accounting entities, may be classified under two broad headings: first and most complex is the appropriation accounting system; the second, is the disbursing system.

---

[39] *Ibid.*

[40] Entity is defined as meaning "In Government, an organization or any integral part thereof for which there is a duty to render an accounting." Navy Comptroller Manual, *op. cit.*, Appendix A, p. B-a-15.

The appropriation accounting system is the medium through which spending control is exercised. Control devices are used at each level in the hierarchy of management from the Congress down to the operating units. These control devices take on many different forms, and frequently duplicate, overlap and conflict with one another at various levels.[41]

The disbursing system on the other hand, is not a control device over the amount of public funds expended from the U.S. Treasury, or is it intended to be, since by the time the disbursing officer is presented with the vouchers for payment, the goods and services have already been received, leaving no other recourse but to pay the just amount due.

Appropriation Accounting: The Control System

It is through the appropriation accounting system that Congress exercises its control over the "nation's purse." Control is exercised by use of the following instruments:

1. The Appropriation Acts

2. Revised Statutes 3679

3. Independent Audit Reports by the GAO

4. Reports of obligations and expenditures from the Defense Department.

The Congress is mindful of this power and jealously

---

[41]<u>Supra</u>, p. 28 for example of a control device used by the President.

guards it through its investigative auditing agent, the Comptroller General; dollar limitations on the amounts which may be switched between appropriations and sub-heads; and specific restrictions written into the acts.

The function of Congress in the appropriation process is similar to that of a Corporation President in the financial management of a company. Budgets are prepared and presented by the operating divisions, arguments are heard, adjustments are made, and finally the approved modified budgets are returned to the operating divisions for implementation. The function of the Executive Branch, on the other hand, is similar to that of the Corporate Controller.

Appropriation Acts:

The term "appropriation" is defined as, "An authorization by an Act of Congress to incur obligations for specified purposes and to make payments therefore out of the Treasury."[42]

An appropriation has its inception in the Federal Budget submission; but once Congress passes the bill and the President signs it, it becomes the law of the land. Each appropriation is a separate expendable fund and for accounting purposes is an independent financial entity. Hence, each military department is required to provide a financial report for each appropriation.

---

[42]Navy Comptroller Manual, op. cit., p. A-1.

Individual appropriations cover broad functional areas of administration, consequently there are generally several sub-heads within an appropriation. These sub-heads are termed "programs." Congress increases it power over government operations by appropriating funds to the sub-head level. Furthermore, Congress does not permit transfer of funds between sub-heads without their prior approval, except that within the Operation and Maintenance Appropriation transfers may be made for differences not to exceed five percent or $1,000,000 whichever is less.

Financial responsibility for Navy appropriations are assigned as follows:

> Each appropriation is assigned to a bureau which will be responsible for budgeting, accounting and reporting for the appropriation as a whole. . . . Within an appropriation, one or more budget activities may be assigned to another bureau for administration.[43]

For instance appropriation 1711804 Operations and Maintenance Navy is sub-divided into sixty-two budget activities split between ten bureaus and offices for administration; the Office of the Navy Comptroller, acting as the accounting agent for the Chief of Naval Operations, is the "Responsible Bureau" for the appropriation as a whole.

Appropriations may be viewed as direct pipelines of spending authority from the Congress to the obligation level, with several throttling valves along the way; one

---

[43]Navy Comptroller Manual, op. cit., Vol. VI, par. 061101-5c.

one at the Executive level (President, Treasurer, Secretary of Defense, and Secretary of the Navy in the apportionment process), another at the bureau level (in the allotment and project order process), and one at the operating unit level (in the form of sub-allotments). These pipelines (one for each appropriation) are not cross-connected at any level from the Congress to the spending level.

Significance of Revised Statutes 3679:

The throttling valves are creatures of the Executive Branch, and were established as a result of the Anti-Deficiency Act of 1870 as amended in 1906, 1907 and 1951.

The Anti-Deficiency Act of 1870, known as Revised Statutes Section 3679, was the outgrowth of the practice, on the part of various departments and agencies of the government, of disregarding appropriation limitations. The practice which the departments followed was to spend appropriated funds as they saw fit until exhausted, and then return to the Congress with a request for supplemental appropriations to carry out the balance of the year's operations. In order to curb this practice the Congress in 1906 stipulated in an amendment to the Act of 1870 that:

> Appropriations . . . shall . . . be so apportioned by monthly or other allotments as to prevent expenditure in one portion of the year which may necessitate deficiency or additional appropriations.

The amendment further stipulated that the agency head was responsible for the apportionment process and for maintaining effective control over it. Although the purpose

and intent of this amendment was perfectly clear, it proved ineffective in practice because penalties were not provided for over expenditure. Consequently, Congress amended the Act again in 1951 in a further attempt to enforce the intent of the original law of 1870. Revised Statutes 3679 now states:

> . . . No officer or employee of the United States shall authorize or create any obligation or make any expenditure (a) in excess of an apportionment or reapportionment, or (b) in excess of the amount permitted regulations prescribed by . . . the Executive Branch. . . . Violators are subject to administrative discipline, including removal from office; willful violators, to fine and imprisonment.

The Secretary of Defense in March 1952 issued a directive implementing this law within the Department of Defense. In it he enumerated the salient features of the law including the following procedure for handling violations:

> XII. VIOLATIONS.
> A. When any provision of Section 3679, Revised Statutes . . . have been violated, the head of the organizational unit under whose jurisdiction the violation has occurred shall promptly report such violation through official channels to the Secretary of the respective military department, or the designated official of the Office of the Secretary of Defense, stating the circumstances and naming the individual or individuals involved. . . . The Secretary . . . will . . . take appropriate disciplinary action, including, when circumstances warrant, suspension from duty without pay, removal from office where applicable, or appropriate action under the Uniform Code of Military Justice. . . . When necessary, such officials shall take immediate action to institute procedural changes to preclude recurrance of violations.[44]

---

[44] *Ibid.*, Vol. II, Appendix A, p. A-1.

The accounting system was designed in conformance with the intent of Revised Statutes 3679. Congress appropriates funds to the sub-head level and it is to this level that obligation authority is initially delegated. The method used to transmit this authority is known as the apportionment process. Furthermore it is from the sub-head level that obligation authority is re-delegated to the spending levels by means of allotments and project orders. Although the restrictions and penalties of Revised Statutes 3679 accompany obligation authority to the spending level, allotments and project orders are frequently issued to activities under the management and technical control of other bureaus. Hence the flow of obligation authority does not follow the formal organization of the Navy. In such instances, this places field activities on sort of a job-shop basis operating within the framework of fixed ceilings and the cumbersome restrictions on hiring-firing of personnel set forth in civil service regulations.

Mechanics of the Accounting System:

Title IV, Public Law 216 charges the Navy Comptroller with the responsibility for proper control and administration of the Navy accounting system. In order to carry out this responsibility, and to provide monthly reports to the Secretary, the Navy Comptroller maintains central Control Accounts over all appropriations, funds, plant property, and personal property (aircraft, ships, etc.)

entrusted to the Navy. These central accounts are maintained in accordance with double-entry bookkeeping methods and principles. In order to provide adequate control and in order to facilitate reconciliation with the "cash" accounts of the Treasurer these accounts are divided into the following two major classifications:

1. Master Control Accounts

2. Appropriation Cash Accounts

The Master Control Accounts:

> . . . are maintained centrally and are the technical heart of the Navy accounting system. The Master Control Accounts are maintained in summary total without regard to appropriations and are designed to show the monetary amount of disbursements, revenues, assets, and liabilities of the Department of the Navy. Cost accounts also are included in the Master Control Accounts structure to show direct application of material costs, manufacturing costs, equipment and plant costs, and values of unexpended stores. . . . Summary financial transactions are posted throughout the fiscal year to a series of control accounts known as a working trial balance. . . . At the end of each fiscal year the Master Control Accounts are closed. Those accounts which retain balances are included in a closing trial balance which is segregated into type of accounts.[45]

These accounts are posted from two types of source data documents:

1. Receipts from Treasury Warrants (Form 523), covering Appropriation Acts passed by Congress

---

[45]*Ibid.*, Vol. VII, par. 071203

2. Expenditures from monthly registers prepared by the Naval Regional Accounts Offices.

The volume and remoteness of expenditure transactions prohibit the posting of individual transactions to the Master Control Accounts by the Navy Comptroller, hence, a decentralized summary procedure is used to gather this information. This operation is explained by the Navy Comptroller as follows:

> Funds and stores expenditures transactions originating in the various field installations are reported through the several Navy regional accounts offices and Headquarters Marine Corps which prepare and submit summarizations of each type of transaction in the form of registers. The several registers received . . . are the media from which postings or journalizations of expenditure transactions are made to appropriate accounts. Certain expenditure transactions, due to their origin or otherwise, are summarized centrally in the form of registers or journals of transactions which are likewise used as posting media.[46]

The NRAO's, of which there are ten, perform accounting services for three distinct levels of management: the operating units (allotees), the Navy bureaus and offices, and the Navy Comptroller. The NRAO's provide the operating units (allotees) with daily summary listings (weekly in some cases) of the transactions recorded since the last month-end report. These summaries indicate the status of each transaction, i.e., whether a commitment, obligation, or an

---

[46] _Ibid._, Vol. VII, par. 071300

expenditure.[47] Furthermore, at the end of the month the allotee is provided a monthly summary for the entire month.

The monthly registers provided the Navy Comptroller are summaries by type of transaction of all of the budget activity registers.

For example, Register Number 5, is the Public Voucher Disbursement Summary Register; it is prepared monthly by the NRAO's for public voucher disbursements reported by all disbursing officers; this register is summarized by appropriation and budget activity. Another example is Register Number 8, which is the NSA Issues Summary Register; it is prepared monthly by the NRAO's for all expenditures for material issued from the Naval Stock Account, reported on Labor Roll Material Charges and Credits (NavCompt Form 2051). This register is summarized by appropriation and budget

---

[47]Definitions: "A commitment is a firm . . . reservation of funds, based upon firm procurement . . . orders, requisitions. . . . which authorize obligations without further recourse."
Ibid., Vol. II, par. 020070.

An obligation occurs when the supplying activity takes action to provide the materials or services, and in the case of a purchase transaction, when the contracting officer signs the contract or purchase order.

An expenditure occurs when the NRAO records a transaction as an expenditure against the appropriation cited by the ordering official on the requisition. In the case of Naval Stock Account material, NIF services, this occurs upon receipt, by the NRAO,of the billing invoice which debits the Naval Stock Fund, or NIF, and credits the appropriation chargeable. In nearly all other transactions, this occurs upon receipt. by the NRAO, of a certified copy of the voucher covering payment in cash by the disbursing officer.

activity. The NRAO also provides the Navy Comptroller with monthly settlement schedules by appropriation. The purpose of these schedules is to provide the Navy Comptroller with the data necessary to reconcile individual appropriations with the Treasury and to settle accounts with other government agencies and departments.

Navy's Annual Financial Report:

The annual financial report of the Navy is published about 1 December of each year covering the previous fiscal year. The report is divided into four sections: fund statements, cost statements, inventory statements, and Navy industrial fund statements. It consists of the Statement of Assets and Liabilities (similar in format to a balance sheet for a commercial firm) and sixteen other supporting statements. The data for the report are extracted from the Master Control Accounts.

> From the Closing Trial Balance of Accounts, various statements and reports are prepared, including a Statement of Assets and Liabilities showing the summary financial condition of the Naval Establishment segregated into current assets, fixed assets, liabilities, and investments of the United States Government.[48]

This report with supporting statements is distributed to each bureau; the Appropriation Committee, House of Representatives; the Bureau of the Budget; and the Office of the Secretary of Defense. The statements comprising this report

---

[48] Ibid., par. 071204

are described in detail in the Navy Comptroller Manual, extracts are as follows:

4. STATEMENTS

a. Statement 1 - - Statement of Assets and Liabilities as of 30 June 19 . . . shows in summary form the financial condition of the Naval establishment segregated into assets, liabilities, and investments of the United States government.

b. Statement 2 - - Trial Balance as of 30 June 19

c. Statement 3 - - Appropriations and Disbursements . . . is designed to show the transactions . . . within each appropriation including . . . unobligated balances . . . amounts expended from each appropriation. . . . The total amount expended for all appropriations agrees with the total Naval Disbursements shown in statement 5.

d. Statement 4 - - Status of Appropriation Accounts as of 30 June. . . . shows the status of each appropriation as to available balance, unobligated balance and unpaid obligations.

e. Statement 5 - - Statement of Naval Disbursements . . . is designed to show all receipts and disbursements analyzed by the basic cost (purpose) classifications so arranged as to display the current costs for the maintenance and operation of the Navy.

f. Statement 6 - - Appropriation Charges by Purpose and Source. . . . covers all receipts and disbursements under each appropriation including cost (purpose) distribution of the material acquired in prior and current fiscal years and issued to final expenditure accounts during current fiscal year.

g. Statement 7 - - Disbursements by Location by individual disbursing officer.

h. Statement 8 - - Costs of the Navy, 1794 through 30 June 19

i. Statement 9 - - Naval Stock Fund Operations. . . . shows assets, liabilities and capital of the Navy Stock Fund in comparative form; a summary of changes in working capital; an analysis of inventories. . . . by material categories.

j. Statement 10 - - Appropriations Purchases Account, 19. . . . shows total value of inventory (finished goods) on hand at the beginning of the year; receipts . . . transfers, gains, losses; the value of inventory (finished goods) on hand at the end of the fiscal year.

k. Statement 11 - - Shipbuilding and Conversion Stores Account, 19. similar to statement 10 except material is designated for use in the shipbuilding and conversion program

l. Statement 12 - - Marine Corps Stock Fund Operations. similar to statement 9

m. Statement 13 - - Marine Corps Appropriation Stores Account, 19. similar to statement 10

n. Statement 14 - - Manufacturing Account, 19 . . . is designed to show the value of work in process in the various stores accounts at the beginning of the fiscal year, the total labor, material, and overhead charges applied, the completed work costs credited during the fiscal year; and the value of work in process at the end of the fiscal year. This statement is subsidiary to the various stores account statements as such work in process values are actually fund value.

o. Statement 15 - - Inventory by Stock Class or Federal Groups as of 30 June 19

p. Statement 16 - - Inventory by Management Categories, as of 30 June 19 - - rearrangement of statement 15 by Navy Inventory Management Offices - Supply Demand Control Points

q. Statement 17 - - Naval Industrial Fund Operations . . . shows the consolidated financial condition of the Navy Industrial Fund as to assets, liabilities, and investments of the United States Government. It also contains . . . for each activity a Statement of Financial Condition . . . and a Statement of Income and Expenses.[49]

In addition to the annual report, the Navy Comptroller also provides the bureaus, the Appropriations Committee, House of Representatives, Bureau of the Budget, and the Office of the Secretary of Defense with the monthly report on Budget Status (DD Form 1176) and the analysis of Appropriation Status by Activity and/or Project (DD Form 690N).

Analysis of these reports leads to the following conclusions:

1. Congress is provided financial data reflecting whether the funds provided were expended in accordance with

---

[49] Ibid., par. 076100

the appropriation acts which made these funds available for expenditure. Congress is also provided with a report of disbursements by geographical location, this enables individual Congressmen to assess the impact of Navy programs on their home districts. Congress cannot by itself manage the military departments. It does review the programs of the military during the budgetary process, and states its decisions in the form of appropriation acts. It expects the Executive to provide effective internal management and has passed legislation to carry this out.

2. The Executive - the President, the Secretary of Defense, and the Secretary of the Navy - is not provided data in a form that will enable effective internal financial management to be carried out. The organization of the operating forces of the Navy is based upon requirements generated by large pieces of hardware - aircraft and ships. The hardware is selected on the basis of requirements generated by assigned missions and tasks. But the costs are not reported by missions and tasks. Instead costs are reflected under two broad headings, capital and operating; and are classified into functional categories within these two headings, examples are: ships, aircraft, shore activities, departmental, inventories, military costs, research, etc. The reports do not indicate whether too much or too little is being authorized for expenditure. No measurement against established goals is in evidence. In brief, the reports do not meet the needs of internal management.

CHAPTER IV

A CONTRAST OF THE APPLICATION OF ACCOUNTING PRINCIPLES: NAVY VERSUS CORPORATE ENTERPRISE

Total-Optimization VS Sub-Optimization

The terms "total optimization" and "sub-optimization" appear throughout a great deal of current management literature, and the level in the management hierarchy where one starts and the other stops has a definite influence upon the character of the accounting system and procedures used throughout the particular organization. Total-optimization relates to the concept of setting profit making goals for only those levels of management that possess decision making authority as to component costs, material sources, manufacturing techniques, and product design. Sub-optimization, on the other hand, requires that each subordinate unit operate so as to obtain the highest possible profit. Thus, under the sub-optimization concept, organizational goals are not always in consonance with the goals of subordinate units. For instance the production manager may be able to produce a particular product efficiently and at low cost, whereas the marketing division may not be able to market the product

because of poor design. Hence, sub-optimization has tended to foster internal schism and to segment the organization into isolated self-seeking units.

The principle of total-optimization, as explained by Mr. P.C. Salman of Socony Mobil Oil Company, is as follows:

> I would like . . . to describe our functions of control . . . in an operating organization whose basic purpose is producing a profit. . . . Probably the most important step taken by . . . management during reorganization of the company during 1959 was the abandonment of the concept of functional organization at the top level. Formerly each major activity or function in Socony Mobil was considered responsible for running its own particular part of the business at a profit. . . . in order for functions to have true profit responsibility, the functional organization unit should have complete decision-making authority on volume, price and cost elements. . . . they could not have this authority. In addition this . . . had the effect of . . . diverting their attention from the elements for which they were accountable: for example in the case of a refinery manager, his primary concern should be refining expenses and efficient usage of crude oil and other input materials. . . .
>
> Our operations fell . . . into two groups, . . . each of whose profits could . . . be determined, planned, and controlled separately. The first group consists of exploration and producing, the second of marketing, pipeline transportation, refining, and crude purchase and storage (called the "complex"). Within the "complex", each manager . . . is recognized as making a contribution to the total profit of the complex either in the form of controlled or reduced costs or in the form of increased sales realization. . . . Also . . . any management decision affecting the operation should be viewed in terms of its effect on the total complex.[50]

---

[50] P.C. Salman, former Comptroller, Socony Mobil Oil Company, Inc., in an address before the Navy Graduate Comptrollership Program at the George Washington University on January 5, 1961. Socony is among the top ten industrial corporations in the U.S.

Most diversified companies use the concept of total-optimization up to and including the individual factory or plant management level. Above this level the concept of sub-optimization is followed. This policy causes competition between entire factories rather than between functions within a factory.

The situation within the Navy is not quite so clear, since below the Office of the Navy Comptroller the obligation authority fans out along appropriation lines through the various bureaus to the field activities and operating units. It is evident however, that the principle of sub-optimization is practiced by most management bureaus down to the field activity level, but only within individual appropriations and allotments. The result of this has been that it is not uncommon to witness decisions being made based upon the best interests of some particular appropriation or allotee rather than on the overall good of the Navy. To cite an example, (1) inventories are procured and shipped to first destination from one appropriation, (2) inventory control offices placing procurement and respositioning of stocks from another appropriation and (3) the transportation and freight bills from a third appropriation. The availability of funds within each of these appropriations has a profound influence on stock levels and the positioning of stocks near consuming activities which are funded from a still another appropriation. Generally a typical Navy Base is composed of a Shipyard, a Supply Center, a Naval Station, an Air Station, a Public

Works Center and a Hospital. All of these activities are funded by numberous allotments and project orders from several appropriations. The Naval Base Commander is not in the channel of budget submission or in the channel of flow of obligation authority for these activities, hence it is only through his superior rank that his influence is felt. Most of the funding problems of the Base Commander stem from the fact that funds are not available in the correct allotment or project order to pay for the necessary work which he needs done. He does not have authority nor the information required to combine functions, eliminate duplication or exert other management controls over his base nor does he have authority to shift funds.

Sub-optimization by appropriation and allotment has had the effect of forcing the development of internal statistical reporting systems tailored to meet the requirements and further the goals of the particular bureaus involved.

Corporate Accounting - A Pyramid of Horizontal Layers of Accounting Entities

If one were to view the organizational structure of a corporate enterprise from the bottom up, he would see three horizontal layers of accounting entities: the first at the factory level, the next at the division level, and the third at the main office or corporate level. It is at the factory management level that the first full accounting analysis is made, since it is at this level that component costs can

best be determined and controlled. The factory manager bases his decisions primarily on financial and management reports prepared from data contained in a single set of books which have been maintained in accordance with double-entry principles and practices. The data contained in these records are the result of posting individual financial transactions as they have occured during the accounting period. The heart of these records is the ledger accounts.

Generally speaking the ledger accounts of industry are maintained as they appear on the balance sheet, income statements and other reports which management requires. That is, they are grouped into asset, liability, owner's equity, revenue and expense categories. Depending upon the degree of control required, these accounts are sub-divided into subsidiary accounts. Transcending these accounts and tying them together are books of original entry; these records are termed "Journals". The Navy uses a similar arrangement but the term used for the books of original entry is "ledgers". Journals are simply log books listing in chronological order the financial transactions as they occur and indicate the accounts in which the accounting data have been entered.

The degree of ease and facility of use of this system is dependent upon the make-up and arrangement of the accounts and the classification of the accounting data resulting from the business transactions. Glenn A. Welsch, speaking for the accounting fraternity, explained the significance of this point very well when he stated:

> It is important that accounting techniques involving the recording of basic economic data be kept flexible so that the resulting information will lend itself to further and varied analysis. . . . Since all needs cannot be anticipated at the time of initial recording a wide range of raw data should be recorded initially with a minimum of classification. Judgmental decisions are thus minimized in the initial recording process and there is no reflection of bias related to a specific objective or need. . . . In order to control business operations it is important that a very definite and particular approach to account classification be followed with a minimum of allocation and with a close tailoring of the system to the organizational structure of the firm . . . Since control is achieved through people . . . . accounting based data must be reported primarily in terms of the responsibilities of people for internal control purposes.[51]

Navy Accounting - A System of Vertical Accounting Entities

Whereas corporate accounting consists of horizontal layers of accounting entities, Navy accounting consists of a system of vertical accounting entities tied together by the Master Control Accounts in the office of the Navy Comptroller. These accounting entities follow appropriation, sub-head, and allotment channels, and are not cross-connected below the appropriation level. Hence, it is only at the Navy Comptroller level that an overall analysis of accounting for appropriations can be made. Vertical accounting entities narrow the latitude of management flexibility at each level

---

[51]Glenn A. Welsch, et al., "Report of Committee on Management Accounting," The Accounting Review, (April, 1959), p. 211.

in the hierarchy; the Secretary of the Navy is not authorized to shift obligation authority between appropriations, Bureau Chiefs are not authorized to shift obligation authority between allotments or between project orders. Navy management is a paradox in that Navy Regulations place great responsibility and authority on a Commanding Officer, whereas the appropriation-allotment system places the Commanding Officer in a strait-jacket.

The function of the master control accounts is quite similar to the ledger accounts maintained by the factory manager in that the data contained in those accounts provide the information necessary for compilation of detailed overall financial reports. The accounts maintained at the station level, however, are not centralized nor set-up to provide a complete financial analysis similar to that performed at the factory level. The Navy inventories, for instance, are "owned" by about twenty separate inventory managers; the station commanding officer is responsible for these stores and submits inventory reports to appropriate control points. The station, however, only "owns" those items which are withdrawn from inventory and "paid" for out of the operation and maintenance appropriation.

The roots of the Navy system can be traced back to the Navy Appropriation Structure, the bureau organization, the project order and allotment system, the General Accounting Office, and the Congress.[52]

---

[52]<u>Supra</u>, pp. 13-24

Furthermore, the Navy system is based upon the flow of obligation authority downward from the Congress, whereas private enterprise is based upon the flow of net profits upward.

Accounting - A Medium of Communication

Accounting in the business world functions as a communications medium; fundamentally, it is the language of the corporate enterprise. It is not, as some accountants may lead one to believe, an end in itself. Welsch explained financial communications in these terms:

> To be most useful to management, accounting information must be tailored to the needs of those who make decisions at the various levels of responsibility. . . . Accounting information does not itself effect the proper business decision. It finds usefulness only to the extent that there is communication to responsible individuals in such a way as to motivate these individuals to appropriate action. Thus its usefulness is largely dependent upon adequate oral and written communication and a proper attitude of receptiveness on the part of management.[53]

W.S. Rothwell, with eighteen years experience in public accounting with Price Waterhouse, explained financial communications in this manner:

> Other people beyond the direction and control of the financial fraternity are involved in the dissemination of financial information and in financial decision making. . . . It is difficult to separate the subject of financial communication from the

---

[53] Welsch _et al._, _op. cit._, p. 213.

subject of business communication generally. . . . Business and financial communication is a two-way street or it is nothing. . . . Effective business communication starts at the top. . . . In any business organization, attitudes and interests are transferred downward.[54]

Financial communications are classified under two broad headings: internal communications and external reports. Internal communications take on many forms, including such basic documents as journal vouchers, stores transfer invoices, material requisitions, and inventory reports. Besides basic documents, internal written communications include comprehensive reports to management, such as: cost analyses, cash flow statements, and budget and performance evaluation. External reports, although generally one-way communications, range from the broad overall statements, such as the annual reports to the stockholders, to detailed tax returns to the local, state, and federal government.[55]

External Communications

Probably the most familiar of the conventional business forms of external communications are the balance sheets and the income statements such as those contained in

---

[54]W.S. Rothwell, "Financial Communication: Where, Why, How and Who," The Controller, (September, 1960), p. 408.

[55]An idea of the magnitude of the tax returns required of private enterprise was given by Mr. John Van Pelt, Vice-President and Controller of Vulcan Materials Company, during a lecture before the Navy Graduate Comptrollership Program at the George Washington University on March 17, 1961. He stated that his company, which operates two chemical plants, one de-tinning plant, and 130 quarries located along the eastern seaborad, submitted approximately 400 separate tax returns for the calendar 1960.

the annual reports to the stockholders. These reports and statements are used by the external analyst to determine if a particular company is a good short-term credit risk, a place for a good long-term investment or a good stock investment. These determinations are usually made on the basis of a five-year comparative analysis of the statements of a selected company with those of four or five other leading companies of the same industry. A commercial banker or other short-term creditor is primarily interested in the ability of a prospective borrower to meet current obligations promptly. Short-term creditors generally compute a number of current asset ratios, such as the current ratio, the quick ratio, the inventory turn-over and the collectibility of receivables.

Analyses similar to this are prepared by prospective long-term creditors and stock investors. Since their point of view (goals) are not the same, the data and ratios which they study are also different. For instance, Bogan states that:

> While the long-term creditor is keenly interested in the working capital position of the borrower as an indication of ability to pay interest and principal even if earnings decline, he will also find valuable the ratios of total liabilities to tangible net worth, net worth to total assets, funded debt to total capitalization, funded debt to net quick assets and tangible fixed assets to funded debt.[56]

---

[56] Jules I. Bogan, Financial Handbook (3rd ed. rev.; New York: The Ronald Press Co., 1952), p. 255.

On the other hand, the stock investor is interested in the dividend paying ability and dividend policy as well as the potential growth possibilities of the company. These factors are measured by still a different set of yardsticks.

Furthermore, the businessman understands the historical significance of the facts set forth in the reports. Kennedy and McMullen explain the significance of historical facts as meaning that:

> The price level - that is the cost - as of the date of acquiring fixed assets is, as a rule, stated in the accounts rather than the reproduction or replacement cost. It should be clear, therefore, that the balance sheet does not show the financial position of a business in terms of current economic conditions, because historical costs rather than current costs are given for most of the items. Appraised values may have been substituted for cost.[57]

The significant point of this discussion is that these reports are meaingful to those that truly understand the language of the business world and the environment in which this medium of communication operates.

The Navy Balance Sheet

The Comptroller of the Navy prepares an annual statement of assets and liabilities which in many respects is similar to the balance sheet prepared by private business

---

[57]Ralph D. Kennedy and Stewart Y. McMullen, Financial Statements, Form, Analysis, and Interpretation (3rd ed. rev.; Homewood Illinois: Richard D. Irwin, Inc., 1957), p. 5.

concerns. The major headings of both statements are set forth in Figure 1 for comparison. The Navy statement compares closely to that of a balance sheet of a company in process of going out of business; in other words, the amount indicated near the bottom of the statement under caption "Appropriated Funds (unexpended balance)" is the amount remaining in the appropriation accounts and available to liquidate the outstanding commitments and obligations in process at the end of the fiscal year. This can be likened to the use of retained earnings by a company which anticipates very little if any further revenues. The Navy treatment of cash advancements to disbursing officers from the U.S. Treasury is similar to the method used by business enterprise in the accounting for short-term loans; that is the cash in the hands of the disbursing officers is carried as a current asset, and the offsetting entry is carried as a current liability under the caption "advances received."

One important difference between the Navy statement and business balance sheet is that corporate enterprise provides for depreciation of its fixed assets whereas the Navy does not. This means that the Navy carries its fixed assets on the books at full acquisition cost until declared excess, scrapped, or destroyed. The external analyst cannot determine by review of the Navy statement what portion of the fixed assets (ships, aircraft, weapons, facilities, and plant equipment) have become obsolescent, obsolete, or have outlived their combat usefulness. In other words, military

FIGURE 1

COMPARISON OF THE NAVY STATEMENT OF ASSETS AND LIABILITIES WITH A CORPORATE BALANCE SHEET

Navy's Statement of Assets and Liabilities	Business Balance Sheet
Current Assets:	Current Assets:
Cash	Cash
Accounts Receivable	Accounts Receivable
	Less: Estimated Uncollectible Accounts
Inventories	Inventories
	Less: Estimated Market Decline of Inventories
Prepaid Material	Prepaid Expenses
Advances and Deferred Charges - NIF	Deferred Charges
Total Current Assets	Total Current Assets
Fixed Assets:	Fixed Assets:
First Costs of Ships, Aircraft, etc.	Machinery and Equipment
	Less: Accumulated Depreciation
First Costs of Shore Stations	Buildings
	Less: Accumulated Depreciation
	Land
Total Fixed Assets	Total Fixed Assets
Total Assets	Total Assets
Current Liabilities:	Current Liabilities:
Accrued Expenses, NIF only	Accrued Payables
Accounts Payable	Accounts Payable
Advances Received	Customer Accounts with Credit Balances
	Notes Payable
Total Current Liabilities	Total Current Liabilities
	Total Long-Term Liabilities
Total Liabilities	Total Liabilities
Investment of U.S. Gov't:	Owner's Equity:
Appropriated Funds, (Unexpended Balance)	Retained Earnings
Property Investment (Land, Plant, Vessels, Stores, Equipment, etc.	Capital Stock
Total Liabilities and Investment of U.S. Gov't.	Total Liabilities and Owner's Equity

capability - or readiness or stature - for any given asset is carried on the books at full 100% original dollar value until disposed of. Corporate enterprises, on the other hand provide for orderly depreciation of their fixed assets over the economic life of the assets involved. In many instances the economic life is comparably short since it is measured in terms of its contribution to the profit making capability and not necessarily to the physical condition of the asset.

The Income Statement

The Navy has not developed a statement of revenue and expense comparable to the income statement of corporate enterprise. The reason for this is that no scheme has been developed to convert military readiness, military statue or military capability into meaningful financial terminology in the same sense as net profits reveal the degree of success or failure of a business.

As stated in the previous chapter, the Navy does prepare numerous reports besides the statement of assets and liabilities, but these are subsidiary reports which provide details for the major headings of the statement of assets and liabilities.

Internal Reports

The financial data required to prepare various reports for the decision-making centers at all levels of

management is extracted from a single set of books maintained in accordance with double-entry bookkeeping principles and practices. Therefore, internal reports emanate from the same set of records:

> It is important . . . that organization and operation of the accounting function reflect the proper perspective with regard to (1) internal reporting to management, (2) external reporting to stockholders and the general public, and (3) reporting to governmental agencies. To overemphasize any one of these objectives leads to serious limitations on the use of accounting information for needs which cannot be anticipated at the time of the first recording.[58]

Internal reports differ from external reports in that they are generally more comprehensive and are submitted at more frequent intervals. The reporting cycle starts at the lowest management entity of the corporate structure, that of the factory or plant manager. The purpose served by internal reporting is to measure the accomplishment of subordinate units against predetermined goals set by management, and to account for the assets entrusted to the subordinate manager's care and use. In the business world the underlying goal which the accounting system is designed to measure is the positive or negative contribution of subordinate units to the profit making capability of the enterprise.[59]

---

[58]Welsch _et al._, _op. cit._, p. 212

[59]The objectives for obtaining the profit making potential vary widely between interested parties and sometimes are in conflict. For instance, the labor union boss uses such information at the collective bargaining table in

The President of the Minnesota Mining Company, presented a revealing insight into corporate management policy in regard to goal setting, measurement of accomplishment, and profit making when he stated:

> There are two objectives of the Controller function:
> 1. Recommend a long-range profit target for each division in terms of percentage of profit to sales.
> 2. Prepare annual forecasts of sales, costs and profits for each operating division and subsidiary, and to review them monthly with management. . . . Profit targets, expressed in terms of sales - profit ratio, are established by top management with the division heads after careful study of the product and markets in which it will be sold. Targets are not changed when not met. . . . Our real objective is to keep our operating people thinking in terms of doing things better. We call this our "Programs for Profits".[60]

A similar procedure is used by most successful corporations. For instance, within the American Cyanamid Company each subordinate plant, laboratory and associated company submits a monthly report of its operations.[61] These reports are reviewed and consolidated on the division level, and forwarded to the New York Office for consolidation into

---

setting wage demands, whereas company management uses it as a lever to reduce union feather bedding and to increase worker productivity; the stockholder uses net profits - along with other data - in formulating his decision to buy or sell; and the prospective bond buyer uses such information in formulating conditions under which the company must conduct their business in order that he can obtain adequate security for his investment. Outsiders, however, must obtain their information from external reports.

[61]C.B.E. Rosane, Comptroller, American Cyanamid Company, in an address before the Navy Graduate Comptrollership Program at the George Washington University on November 15, 1960. Cyanamid Net Sales to Customers during 1959 amounted to approximately $600 million.

a single report for the monthly meeting of the board of directors. Included in this report is the statement of earnings, which sets forth a comparison between actual performance, with the budget and with last year's actual performance for both the current month, and cumulative current year. Meaningful captions are listed, starting at the top with net sales to customers (intra-company transfers are not included) and culminating at the bottom with consolidated net earnings after taxes. Financial data reflected on the statement is rounded to the nearest $1000 in order to present management with significant data before it becomes stale. The budgets are revised twice during the year: in the spring and in the fall. Goals are set on the percentage return on sales and the percentage return investment. The report also contains a balance sheet which indicates the net change current month, and net change since the end of the preceeding year. A production and cost report is used in the company's job order cost accounting system to determine cost of goods sold and is included in the report. On the job order cost analysis sheets, preset goals are compared with actual performance and the resulting variances are indicated for use by management. The goals include both direct and indirect costs.

Internal reporting channels within the Navy follow management control lines of authority which frequently differ from the channels through which obligation authority is delegated. Frequently, activities under management control

of one bureau are issued allotments and project orders for missions and tasks under sponsorship and control of other bureaus. Since appropriation structure and the bureau organization are, as Mosher says "products of evolutionary development", the reporting systems used within various appropriations and bureaus differ.[62] For instance the various work measurement systems during their development have been tailored to fit the requirements of the individual management bureaus. Generally speaking these systems are highly effective. For example, the Office of Navy Material and the Bureau of Supplies and Accounts, budget and distribute personnel ceilings and operating funds (allotments) based on analyses of work measurement reports from field activities under their management control. Work measurement reports submitted by field activities under the management control of the Bureau of Naval Weapons are used by station commanding officers for preparation of budgets, and for budget execution of alloted funds; also by the program manager within the bureau for preparation of budgets and of allocation and apportionment requests; and for alloting funds to field activities. The allotments differ from the budget requests by the amount of variance of program changes occasioned between the date of the budget submittal and the date of the allotment grant. One section of the report presents the

---

[62] Mosher, op. cit., p. 85.

overall station performance for evaluation by the commanding officer and the program manager at the bureau. The report is constructed so that a comparison of actual performance is made with the budget plan, all manhours - military and civilian are accounted for, a comparison of local station group work norms is made with bureau standard work norms. The section of the report covering the operations of a typical overhaul and repair department serves the following purposes at both the station and bureau level:

1. Controlling expenditure of funds and manhours. allocated to overhaul, repair, and modification of aircraft, engines and related programs.

2. Controlling performance at shop, branch, and division levels.

3. Developing standards and work norms in terms of manhours and costs.

4. Determining on basis of costs whether to continue overhaul of old aircraft or buy new; and to compare costs of commercial overhaul vs Navy overhaul.

Thus, both the commanding officer of the station and the program officer at the bureau are made cognizant of performance against plan for each major function of each department of the station as well as for the station as a whole.

A different type of accounting is used at industrial type facilities operated by the Navy. Most of these activities operate under a system known as Naval Industrial Fund

(NIF) accounting. This system incorporates the use of job order cost accounting and financial accounting procedures which is very similar to the procedures used by a commercial manufacturing company. There are a few minor differences due to the peculiarities of the military services. Five significant differences are:

1. Since the Navy is on an obligation basis, NIF activities are required to go through the committment, obligation, and expenditure procedure.[63]

2. Besides the raw materials inventory, work in process inventory, and finished goods inventory familiar to the factory manager, NIF activities use one additional inventory account entitled "Direct Materials Inventory" (DMI). This account is used to hold long-lead time material ordered specifically for a certain job. This material is held in DMI until required for installation. Some activities by-pass the DMI account for items procured locally, while others wash all items through DMI to work in process inventory.

3. NIF activities are not permitted to operate at a profit. To accomplish this two accounts are used to absorb differences: estimated applied indirect (overhead) and retained earnings.

4. To compensate for the lack of profit motive, the chief of the management bureau prescribes certain definite

---

[63] _Supra_, pp. 26-27 for explanation

limitations on overhead rates, amount of retained earnings, and direct material and labor costs.

5. The NIF does not utilize the business techniques of depreciating fixed assets.

CHAPTER V

CONCLUSION

The fact that commercial double-entry bookkeeping originated during the medieval ages, and was not required in governmental practices until 1956 by Public Law 863,[64] indicates in a small way the long road which must be traveled to bring Navy accounting up to the standards which prevail throughout corporate enterprise. Since World War II, Congressmen have begun to realize that it is beyond their capability to manage the Department of Defense. It is enough for them to provide general overall guidance and rely on the Executive Branch to perform the day to day details of management. The Congress has expressed this philosophy through the enactment of several laws: (1) Public Law 253, created the position of Secretary of Defense and vested in that position the power and authority necessary to manage and direct the armed forces; (2) Public Law 216, transferred from the GAO to the Secretary of Defence the responsibility and authority for

---

[64] Public Law 863 provides for accrual accounting and cost-based budgeting. A prerequisite to these techniques is the installation of the double-entry bookkeeping system.

design and maintenance of an effective accounting system; (3) Public Law 784, recognized that financial management techniques undergo continued change and established the Joint Committee to Improve Accounting in the Federal Government as a permanent body; and (4) Public Law 863, established the requirement for instituting fundamental commercial accounting techniques.[65]

Congress intends for the Department of Defense to be managed in an efficient and effective manner by the Secretary of Defense. This means that the Navy accounting system must be modified to accomodate the reporting requirements of both the Congress and the Secretary of Defense. These requirements are as different in scope and detail as are the requirements for financial accounting and cost accounting in the business world.[66]

People tend to forget that the accounting systems used by corporate enterprise are the product of development over hundreds of years. Since these corporate accounting systems are tailored to meet the needs of a profit-making organization, they cannot readily be installed in the military establishment without modification. The basic accounting principles of corporate enterprise, however, do have application to the military establishment. For instance, most

---

[65] <u>Supra</u>, pp. 13-23 for full account of the significance of these laws.

[66] <u>Supra</u>, p. 60

accounting authorities maintain that management must first decide what its mission, purpose or goal is. Next the structure of an organization must be determined to accomplish these ends; and is necessary for the installation of an accounting system to make the various decision points financially accountable. A typical statement from one authority is:

> Perhaps one of the reasons why private industry has been so much more successful than public business is that private management has given more attention to, and made more effective use of accounting personnel and accounting controls. . . . With the growth of business organizations . . . personal supervision and direct contact are impossible except to a few first-line supervisors. . . . Something more is called for. . . . The "something" required is, first an adequate organizational structure with authority delegated and duties clearly defined. . . . and second, a means must be available for determining how well these duties have been performed. . . . The accounting service is a means for making management's work more effective.[67]

The present Navy system does not conform with these principles. The flow of obligation authority does not follow the same channels nor emanate from the same source as do the operational directives. In other words, funding does not follow the formal organization.

For example, much of the criticism leveled at the Navy can be predicated on the current practice of providing funds from multiple sources to accomplish tasks and missions issued and directed by another organizational entity. Many

---

[67] Smith and Ashburne, <u>op. cit.</u>, p. 239

of the seemingly stupid things that are done are brought about by a series of circumstances: first, there is a given task or mission to be performed; second, a shortage of funds in the usual funding source (appropriation); and third, a relatively long position in another appropriation. This situation generally results in accomplishing the mission via an expensive and indirect route. A highly overworked example of this is the case of a shore station which reduces its man-hour expenditures for advance planning of material requirements to reduce overhead costs. This results in a shift of costs to the supply system in the form of premium transportation or excess inventories or both. An example common to the operation forces is the practice of not replenishing inventories of repair parts and diverting the funds to other purposes; the obvious result of this practice is a lowered material readiness posture.

The Navy Accounting System in use today was designed under the supervision of the GAO auditors during the period from 1921 to 1950. Its primary purpose is to report the degree of compliance with the will of Congress as expressed in the appropriation acts. It provides details as to who spent how much for what and when. The underlying concept is deceivingly simple: Congress appropriates funds for specific purposes and the Executive Branch spends it, occasionally for other purposes; the accounting system measures the variance.

It is not a financial management system in that it does not equate the things the Navy does - missions and tasks - to the total costs of performing these missions or tasks or to predetermined goals or standards.

The immediate problem facing the Navy is the development of a method for rearranging its accounting system so as to array individual costs to specific weapon systems and missions and still be able to render the present reports to the Congress. Neither the Navy chart of accounts nor the classification of expenditures are arranged in such a fashion that a specific weapons system or mission can be extracted and compiled in one total amount. During the next few years the military can expect the Congress and the President to place more and more emphasis on a comparative analysis of total costs of weapon systems and performance of missions. The service that can perform a certain military task or function at least cost and can prove its case in financial terminology will be granted the funds to do so at the expense of the other services. Business Week magazine in a preview article on Secretary of Defense McNamara, made the following ominous prediction:

> The next budget will probably add less than \$1.5 billion to Eisenhower's \$42 billion military appropriation request but it will involve massive reshuffling of funds for individual projects. The mood, as one top-level Kennedy official puts it, seems to be that 'there's much more to be gained by spending \$42 billion or so more nearly correctly than by simply adding billions'.[68]

---

[68]"'Pro' Manager Takes on Military", Business Week, February 11, 1961, p. 98.

Another perplexing problem in need of solution is the development of a method which states military readiness, capability, and performance in financial terminology in a manner which measures their true worth to the nation in the same fashion that net profits measures management effectiveness of corporate enterprise.

In conclusion, the Navy accounting system provides information to individual congressmen pertaining to past and anticipated expenditures in their home districts;[69] but only provides information of marginal value to the Secretary of the Navy, the Secretary of Defense, and the President.

---

[69] Supra, p. 18.

BIBLIOGRAPHY

Public Documents

U.S. Constitution. Art. I, Sec. ix, Par. 7.

U.S. Congress, Budget and Accounting Act of 1921, Public Law 13, 67th Cong., 1st Sess., 1921.

U.S. Congress, Government Corporation Control Act, Public Law 248, 79th Cong., 1st Sess., 1945.

U.S. Congress, National Security Act of 1947, Public Law 253, 80th Cong., 1st Sess., 1947.

U.S. Congress, National Security Act Amendments of 1949, Public Law 216, 81st Cong., 1st Sess., 1949.

U.S. Congress, Budget and Accounting Procedures Act of 1950, Public Law 784, 81st Cong., 2nd Sess., 1950.

U.S. Congress, An Act to Improve Governmental Budgeting and Accounting Methods and Procedures, and for Other Purposes, Public Law 863, 84th Cong., 2nd Sess., 1956.

U.S. Bureau of the Budget, Improvement of Financial Management in the Federal Government, Bulletin No. 57-5, 1956.

U.S. Senate, Committee on Government Operations. Financial Management in the Federal Government, Senate Document No. 11, 87th Cong., 1st Sess., 1961.

Limited Availability

U.S. Department of the Navy, Office of the Comptroller, Navy Comptroller Manual, NAVEXOS P-1000, Vols. I-VII.

U.S. Department of the Navy, Office of the Comptroller, The Budget Process in Navy, NAVEXOS P-2254, June 1960.

Books

Bartelt, Edward F. Accounting Procedures of the United States Government. Chicago: Public Administration Service, 1940

Bogan, Jules I. Financial Handbook, 3rd ed. revised. New York: The Ronald Press Co., 1952

Burkhead, Jesse. Government Budgeting. New York: John Wiley and Sons, 1959

Kennedy, Ralph D. and McMullen, Stewart Y. Financial Statements, Form, Analysis, and Interpretation, 3rd ed. revised. Homewood, Illinois: Richard D. Irwin Inc., 1957

Kimmel, Lewis H. Federal Budget and Fiscal Policy 1789-1958. Washington, D. C.: The Brookings Institution, 1959

Kohler, Eric L. and Wright, Howard W. Accounting in the Federal Government. Englewood Cliffs, N.J.: Prentice-Hall, Inc., 1956

Mansfield, Harvey C. The Comptroller General. New Haven: Yale University Press, 1939

Mosher, Frederick C. Program Budgeting; Theory and Practice. Public Administration Service, 1954.

Noble, Howard S. and Niswonger, C. Rollin. Accounting Principles, 6th ed., Chicago: South-Western Publishing Company, 1953

Smith, C. Aubrey and Ashburne, Jim G. Financial and Administrative Accounting, New York: McGraw-Hill Book Company, Inc. 1955

Articles and Periodicals

American Institute of Accountants. "Report of Committee on Terminology," Accounting Research Bulletin No. 9. (May 1941)

" 'Pro' Manager Takes on Military," Business Week, (Feb. 11, 1961)

Rothwell, W.S. "Financial Communication: Where, Why, How and Who," The Controller, (Sept. 1960)

Welsch, Glenn A. et al. "Report of Committee on Management Accounting," The Accounting Review, (April 1959)

Lectures

Ensey, Lot, RADM., USN. An address before the Navy Graduate Comptrollership Program at The George Washington University on February 10, 1961. RADM. Ensey is the Assistant Comptroller of the Navy.

Rosane, C.B.E. An address before the Navy Graduate Comptrollership Program at The George Washington University on February 10, 1961. Mr. Rosane is the Comptroller of the American Cyanamid Company.

Salman, P. C. An address before the Navy Graduate Comptrollership Program at The George Washington University on January 5, 1961. Mr. Salman is the former Comptroller of Socony Mobil Oil Company, Inc.

Van Pelt, John. An address before the Navy Graduate Comptrollership Program at The George Washington University on March 17, 1961. Mr. Van Pelt is Vice-President and Comptroller of Vulcan Materials Company.